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Technical Bulletins: FmHA Community Program Bonds Can Be Sold to Third Parties

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TECHNICAL
BULLETIN

MUNICIPAL TECHNICAL ADVISORY SERVICE
THE UNIVERSITY OF TENNESSEE
IN COOPERATION WITH THE TENNESSEE MUNICIPAL LEAGUE

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FmHA COMMUNITY PROGRAM BONDS CAN BE SOLD TO THIRD PARTIES

by Joseph Muscatello, Jr.

Attention cities who have had their FmHA bonds sold to third parties!!

If your city has a Community Program Bond Issue financed through the Farmers Home Administration (FmHA) you may be interested in the following information.

The loan resolution you signed with FmHA {FmHA 442047 (Rev. 4-9-76)} may include the following provision:

> To refinance the unpaid balance, in whole or in part, of its bonds upon the request of the Government if at any time it shall appear to the Government that the association is able to refinance its bonds by obtaining a loan for such purposes from responsible cooperative or private sources at reasonable rates and terms for loans for similar purposes and periods of time as required by section 333(c) of said Consolidated Farm and Rural Development Act {7 U.S.C. 1983 (c)}.

What this means is that FmHA has the option to require the city to refinance the bond issue on the private market, or if the city does not chose to refinance, FmHA can sell the bonds on the open market. Recently, FmHA has taken advantage of this provision and launched an effort to have some local government units *graduate* (refinance FmHA loans on the open market) loans.

This initiative was brought about by the Omnibus Budget Reconciliation Act of 1986 (OBRA) and the Continuing Appropriation Act of 1987. Among the provisions of these laws is a requirement that specific Federal Agencies sell certain assets. FmHA was required to sell enough Community Program loans to realize $1.025 billion by September 30, 1987. Recently OBRA was amended by the Agricultural Credit Act of 1987 to provide Community Program borrowers the right to purchase their loan on potentially favorable terms before such loans may be sold to other parties. This program expired on July 11, 1988. If you did not take advantage of this program to refinance your issue, your issue may have been sold to another party.

By now you may have received information or requests from the third party who purchased your bonds from FmHA. You should be reassured that if your bond issue was purchased by a third party, the legislation mandating the sale affords a number of important protections, including:

1. The sale of the loan does not change any of the terms or conditions of that loan except as described in number 2. below. The new holder of the loans will have no more right or recourse to the borrowers than FmHA. The new holder cannot and will not require any changes in the interest rate, payment schedule, or collateral.

2. The new holder cannot require a current borrower to refinance (graduate) its loan in the private sector (something FmHA can do if it continues to hold the loan).

3. Community Program borrowers will be entitled to essentially the same rights, privileges, and obligations after the sale. The Secretary of Agriculture is responsible for assuring that the new holder will provide servicing to ensure continued performance of the loan.

4. The sale program does not change a borrower's eligibility to borrow from FmHA in the future.

5. Every effort is being made to protect the interests of both the Community Program borrowers and the ultimate investors.

Many cities whose bonds have been sold by FmHA have received information and requests for materials from the third party holders of the bond issue. The third party, usually a private corporation, may ask you to provide assurances that your city is meeting the requirements of the bond covenant. It may be difficult to tell whether or not the third party is making a suggestion or if it is trying to enforce a requirement of the bond covenant.

The intent of this bulletin is to inform you that what the third party is usually asking the city to do is what is required by the bond covenants. However, some cities are being *advised* to take financial actions that go beyond the legal requirements of the bond covenants. An example of this is the suggestion that a city raise its utility rates to achieve net income over and above what is required to meet the depreciation reserve requirement. Please check your bond covenant to verify the original requirements of your bond issue. These requirements still remain in force, even though FmHA no longer owns the bonds. The suggestions made by the third party may or may not be part of the bond covenant. Where FmHA may have been lax on the enforcement of the covenant, a private corporation may take a stricter attitude. In this light, a corporation may be asking for you to adhere to policies beyond those called for in the covenant.

For Further Information

Further information on the sale of your bonds to a third party may be obtained by contacting Joe Muscatello, MTAS Senior Program Consultant, in Knoxville at (615) 974-5301 or your MTAS Municipal Consultant.